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C O N F I D E N T I A L SECTION 01 OF 03 KUWAIT 005252

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E.O. 12958: DECL: 12/26/2015
TAGS: ENRG EPET ECON BEXP KU
SUBJECT: SAUDI ARABIAN TEXACO CONCESSION IN KUWAIT-SAUDI
DIVIDED ZONE ON SHAKY GROUND

Classified By: Ambassador Richard LeBaron for reason 1.4 (b)

¶1. (C) Summary and Comment: Officials from Saudi Arabian Texaco (SAT), a subsidiary of U.S. oil company Chevron, told the Ambassador on December 10 that SAT was concerned about the Kuwait National Petroleum Company's (KNPC) plans to build a new refinery in an area adjacent to SAT's compound in the Mina Al-Zour area within the divided zone between Kuwait and Saudi Arabia. According to the SAT officials, KNPC is moving forward with its plans for the location of this refinery, despite numerous objections by SAT and despite never providing a response to SAT's requests for more information on KNPC's plans. SAT claims that the location of this refinery would impede SAT's future expansion plans, and legally violates the original concession agreement which gave SAT the right to veto any property development plans in the divided zone. The officials told us that they believe that the GOK's plan for the location of this refinery is designed to force out SAT as part of a GOK strategy to renegotiate the entire divided zone agreement with the Kingdom of Saudi Arabia (KSA).

¶2. (C) Ministry of Energy Undersecretary Issa Al-Own told the DCM during a December 24 meeting that the decision to locate the refinery adjacent to the SAT compound was taken by the Supreme Petroleum Council (SPC) and that there was "no way" the refinery would be built elsewhere. He said that, because it had not heard differently, the GOK was operating under the assumption that the SAT concession with the KSA would not be renewed once it expires in 2009. Al-Own said that the best thing would be for SAT to tell the GOK exactly what the plans were for the concession and that, if the concession was going to be renewed, what SAT's plans are for expansion of its facilities in the divided zone. Given this information, he explained, they might be able to "find a middle ground," in terms of minimizing the impact of this new refinery on SAT. He did not provide any indication that the refinery location was up for negotiation. (This impression was confirmed in a brief December 23 conversation between Ambassador and KNPC Chairman Sami Al-Reshaid.)

¶3. (SBU) Comment: The SAT concession from Saudi Aramco to operate the KSA's portion of the divided zone is one of the few remaining concessions to an IOC in the Gulf region. While the location of the refinery may impact upon SAT's expansion plans, the bigger issue is the renewal, or expiration, of SAT's concession with Saudi Aramco. End Summary and Comment.

Saudi Arabian Texaco: A Quick Primer

¶4. (U) In 1922 Kuwait and Saudi Arabia established a neutral zone between their two countries and decided to jointly operate and split the proceeds from any oil and gas fields in this zone. In 1949 the KSA granted a 60 year concession to Pacific Western Oil Corporation, which later became Getty, which was later acquired by Texaco, which later merged with Chevron. Saudi Arabian Texaco (SAT) is the current name of the descendent of the original Pacific Western concession-holder, and is a fully owned subsidiary of Chevron. This company operates the Saudi portion of the divided zone, while the Kuwaiti portion was operated by the state-owned Kuwait Oil Company (KOC) and was recently turned over to the Kuwait Gulf Oil Company (KGOC), both subsidiaries of Kuwait Petroleum Corporation (KPC). A Joint Operations Committee oversees all decisions regarding operations within the divided zone. SAT has about 420 employees, most of whom live on an enclosed compound in the Mina Saud area, which is within Kuwait's administrative border. The divided zone operations produce a total of about 500,000 bpd of crude.

Dispute Over New Refinery Location

¶5. (SBU) According to SAT, the original 1949 concession agreement stated that the concession holder has the right to use any property within the concession area if needed for operations. The 1968 Partition Agreement between the GOK and the KSA stated that both governments would honor the obligations included in the original concession agreements. The SAT executives said that, in the past, these terms have always been honored by all parties and that any requests for land use in the divided zone were always presented to SAT and to KOC, and no land would be allocated for anything until

each party had approved.

¶6. (SBU) During a December 10 office call on the Ambassador and DCM, SAT President Ahmed Al-Omer and Assistant to the President Bryan Tucker raised concerns about the location of a new refinery planned by the GOK and its impact on SAT. (Note: The Kuwait National Petroleum Company (KNPC) has plans to construct a new refinery in Kuwait with a capacity to handle up to 615,000 bpd of crude. The project is still in the design phase, with an Engineering, Procurement, and Construction (EPC) contract expected to be awarded within the next few months. Fluor is the Project Management Consultant (PMC).)

¶7. (SBU) In early 2005, KNPC began looking for a specific location for its new refinery and was considering a few location options within the divided zone. In February 2005, KNPC communicated these options to SAT through KOC, SAT's partner in the divided zone. SAT objected to KNPC's favored option, directly outside the SAT compound, because it was in an area that SAT considered a "reserve area" kept for future SAT expansion. SAT and KNPC met throughout the Spring of 2005, with SAT remaining firm on its objection to the planned location of the refinery in SAT's "reserved area." The SAT executives said that they did not receive any further communications on the issue until the Fall of 2005, when a number of articles were published describing KNPC's plans to build the new refinery at Mina Al-Zour in a location that SAT considers part of its "reserved area." SAT sent a letter to the Ministry of Energy restating its objection to the refinery location but has not yet received a response.

¶8. (SBU) SAT claims that the location of this refinery would impede SAT's future expansion plans, and legally violates the original concession agreement which gave SAT the right to veto any property development plans in the divided zone. The SAT executives told us that they believe that the GOK's plans for the location of this refinery is designed to force out SAT as part of a GOK strategy to renegotiate the entire divided zone agreement with the Kingdom of Saudi Arabia

(KSA). (Comment: These executives, and other interlocutors, have told us that they believe that the GOK would like to restructure the divided zone agreement with the KSA so that the GOK operates all of the onshore production and the KSA is responsible for everything offshore. End Comment.) SAT believes that its concession to operate KSA's portion of the divided zone agreement will be renewed when it expires in 2009, and is making expansion plans based on this belief. However, SAT expansion, including construction of additional housing units, has been halted pending resolution of the refinery location issue. They asked the Embassy to approach the Ministry of Energy to find out the Ministry's views on the location of the refinery and its impact on SAT.

Min Energy U/S: Renewal of SAT Concession in Doubt
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¶9. (C) Ministry of Energy Undersecretary Issa Al-Own told the DCM during a December 24 meeting that the decision to locate the refinery adjacent to the SAT compound was taken by the Supreme Petroleum Council (SPC) and that there was "no way" the refinery would be built elsewhere. He said that the best place for the new refinery would be in the Shuaiba port area, not the Mina Al-Zour area, and that locating it in Mina Al-Zour would cost the GOK KD 400 million ($1.63 billion) more for the project. Al-Own said that it had to be in Mina Al-Zour because of "environmental requirements and other plans." He also added that "the U.S. military is using the Shuaiba port area," and the GOK "does not want to kick them out." Al-Own said that the refinery plans would not affect the existing area used by SAT for its operations and that it would only affect a small area at the tip of the SAT property, "that SAT wants for a golf course."

¶10. (C) Al-Own linked the refinery location plans to the expiration of SAT's concession agreement with the KSA in 2009, saying that the GOK was operating under the assumption that the SAT concession with the KSA would not be renewed and therefore SAT did not need to worry about any expansion plans. He said that the GOK had made inquiries to SAT regarding the plans for the concession but had not gotten any response. He said that it would not be possible for SAT to construct any new facilities in the three years remaining on the concession agreement.

¶11. (C) Al-Own explained that the GOK could not afford to wait to build the refinery and had to move forward with its plans. Given Kuwait's increasing power needs, he said, Kuwait "needs to have the power plants operating with the refined product (from the new refinery) in four years." He added that the refinery "is a non-profit operation" for Kuwait, and that its sole purpose was to provide Kuwait with fuel to generate much-needed electricity. He said that it was "very painful" to have to locate the refinery in Mina Al-Zour, but that it was Kuwait's "only choice."

The Way Forward: "Finding the Middle Ground"

¶12. (C) Al-Own said that the best thing would be for SAT to tell the GOK exactly what its plans are for the concession and, should the concession be renewed, what SAT's plans are for expansion of its facilities in the divided zone. Given this information, he explained, they might be able to "find a middle ground," in terms of minimizing the impact of this new refinery on SAT. "We need to hear about their plans, we've been open about our plans," he said, adding, "we will cooperate, but we need information." Al-Own concluded by saying that the SPC has the final decision on the location of the refinery and that it was not up to KNPC, KGOC or any other entity. He did not provide any indication that the refinery location was up for negotiation.

¶13. (SBU) The DCM explained to Al-Own that SAT had provided

excellent performance for the KSA and that, unless we hear differently, our assumption is that the concession will be renewed. DCM emphasized that SAT brought significant technical expertise to the divided zone agreement. He concluded by explaining to Al-Own that our major concern is that a U.S. company is caught in the middle of this issue.

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LeBaron